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MONTANA LOTTERY





MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

December 31, 2002

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MONTANA LOTTERY

FINANCIAL STATEMENTS
(Unaudited)

December 31, 2002

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APPOINTIVE OFFICIALS

Gerald J. LaChere, Lottery Director

L. John Onstad, Lottery Assistant Director for Security

LOTTERY COMMISSION

TERM EXPIRES

Clifford Brophy	Columbus	January 1, 2005
Tom Keegan	Helena	January 1, 2006
Betty Wilkins	Missoula	January 1, 2006
Robert Crippen	Butte	January 1, 2007
Vacant		

REPORT DISTRIBUTION

According to Section 23-7-202(9), MCA, copies of this report must be distributed to the following:

Governor - Judy Martz
Director of Dept. of Administration – Scott Darkenwald
Legislative Auditor - Scott Seacat
President of the Senate – Bob Keenan
Speaker of the House – Doug Mood

The law also states "the President of the Senate and the Speaker of the House will determine the report distribution to each member of the appropriate committee of each house of the legislature".

The President of the Senate and the Speaker of the House have requested that this report be distributed to the following committees:

HOUSE – State Administration Committee

Debby Barrett, Chair
Dee Brown, Vice Chair Majority
Larry Jent, Vice Chair Minority
Norman Ballantyne
Arlene Becker
Sue Dickenson
Carol Gibson
Dan Hurwitz
Hal Jacobson
Larry Lehman

Ralph Lenhart
Alan Olson
Bernie Olson
Don Roberts
Clarice Schrumpp
Frank Smith
Pat Wagman
Jonathan Windy Boy
Cindy Younklin

HOUSE – Business & Labor Committee

Joe McKenney, Chair
Don Steinbeisser, Vice Chair Majority
Jim Keane, Vice Chair Minority
Bob Bergren
Rod Bitney
Sylvia Bookout-Reinicke
Nancy Rice Fritz
Dave Gallik
Kathleen Galvin-Halcro

Ray Hawk
Bob Lawson
Rick Maedje
Gary Matthews
Scott Mendenhall
Penny Morgan
Allen Rome
Sandy Weiss
Bill Wilson

SENATE – State Administration Committee

John Cobb, Chair
Mike Sprague, Vice Chair
Kelly Gebhardt

Carolyn Squires
Mike Wheat

SENATE – Business & Labor Committee

Dale Mahlum, Chair
Mike Sprague, Vice Chair
Sherm Anderson
Vicki Cocchiarella
Kelly Gebhardt
Bob Keenan

Sam Kitzenberg
Ken Hansen
Glenn Roush
Don Ryan
Carolyn Squires
Fred Thomas

Montana Lottery

December 2002

Montana Lottery Commission:

The second quarter ended with a large Powerball jackpot of \$315 million won on December 25th. This brought the Lottery's Powerball revenues to the same level as last year and ahead of the budget for the current year at 59% of the total. Montana Cash and Wild Card revenues are running behind last year's and also budgeted revenues for this year (44% and 49%, respectively). Hot Lotto continues to out perform Rolldown, but is not meeting budget expectations. Instant sales are up slightly from last year and at 49% of budget. Revenue from new licenses is up due to additional terminals available for placement. Overall, total revenue for the year is at 52% of budget.

Total operating expenses for the quarter were slightly higher this quarter as opposed to last year, but compare favorably to the budget at 45% of total budgeted expenditures for the year. We continue to monitor expenses and take advantage of economies where possible.

In mid-November, the Lottery began placing *Slingo*, a new \$3 instant game, with retailers. At that time, we did not do any additional advertising. In February, *Slingo* was officially launched including billboard advertising and experienced strong growth in sales, from approximately \$18,000 to \$25,000 revenue per week and over 500 retailers are carrying the game. The game appears to have caught the interest of many players and we hope that it will become a stable game at the \$3 price point, in the manner that Crossword and Bingo have for the \$2 price point.

Sincerely,



Gerald J. LaChere
Director

MONTANA LOTTERY
STATEMENT OF NET ASSETS
December 31, 2002 and 2001
(UNAUDITED)

	Period Ended December 31, 2002	Period Ended December 31, 2001
ASSETS:		
CURRENT ASSETS		
Cash and Cash Equivalents	\$ 967,228	\$ 896,517
Receivables (Net)	2,107,268	1,056,300
Due from Other Funds	2,255	7,863
Inventories	821,228	1,001,357
Other Current Assets	<u>19,810</u>	<u>8,651</u>
TOTAL CURRENT ASSETS	3,917,789	2,970,688
NONCURRENT ASSETS		
Computer, Furniture & Equipment	5,549,820	4,769,593
Accumulated Depreciation	(2,638,758)	(1,859,230)
Software, net of Amortization	533,929	698,214
Multi-State Receivable	<u>1,733,513</u>	<u>2,079,621</u>
TOTAL NONCURRENT ASSETS	5,178,504	5,688,198
TOTAL ASSETS	\$ <u>9,096,293</u>	\$ <u>8,658,886</u>
LIABILITIES:		
CURRENT LIABILITIES		
Accounts Payable	\$ 690,534	\$ 576,820
Estimated Prize Liability	2,399,678	1,622,084
Due to Other Funds	4,036	21,151
Transfer Obligations	2,277,852	1,520,485
Deferred Revenue	184,768	116,555
Current Portion Comp. Absences	101,424	
Current Portion Long-Term Debt	<u>1,081,960</u>	<u>1,028,293</u>
TOTAL CURRENT LIABILITIES	6,740,252	4,885,388
NONCURRENT LIABILITIES		
MUSL Prize Liability	1,719,048	1,727,328
Note Payable	561,976	1,643,937
Accrued Compensated Absences	<u>75,017</u>	<u>164,550</u>
TOTAL NONCURRENT LIABILITIES	2,356,041	3,535,815
TOTAL LIABILITIES	9,096,293	8,421,203
NET ASSETS		
Unrestricted Net Assets	<u>0</u>	<u>237,683</u>
TOTAL LIABILITIES AND NET ASSETS	\$ <u>9,096,293</u>	\$ <u>8,658,886</u>

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN FUND NET ASSETS
FOR THE QUARTERS ENDED DECEMBER 31, 2002 and 2001
(Unaudited)

	Quarter Ended December 31, 2002	Quarter Ended December 31, 2001	Six Months Ended December 31, 2002	Six Months Ended December 31, 2001
OPERATING REVENUES:				
Instant ticket revenue	\$ 2,461,772	\$ 2,502,297	\$ 5,019,256	\$ 4,843,345
Powerball revenue	5,417,866	2,980,031	8,989,351	9,050,445
Montana Cash revenue	974,967	1,336,111	1,806,008	2,343,758
Wild Card revenue	698,845	618,630	1,282,696	1,391,779
Hot Lotto/Rolldown revenue	579,713	160,550	1,148,707	333,147
900 # Income	4,091	5,991	9,557	23,585
License, permits, and misc	1,014	1,041	1,824	1,485
Total Operating Revenues	10,138,268	7,604,651	18,257,399	17,987,544
Cost of Ticket Revenue				
Instant ticket prize expense	(1,432,157)	(1,485,361)	(2,998,522)	(2,763,994)
On-line ticket prize expense	(3,816,181)	(2,443,021)	(6,583,313)	(6,269,563)
Retailer commission	(582,355)	(463,379)	(1,071,727)	(1,047,480)
Cost of tickets sold	(185,045)	(174,873)	(353,819)	(335,771)
Vendor fees	(865,402)	(640,919)	(1,540,422)	(1,509,358)
Net Operating Revenue	3,257,128	2,397,098	5,709,596	6,041,378
OPERATING EXPENSES:				
Advertising	194,501	145,532	262,626	244,780
Advertising Production	25,277	31,773	52,705	85,267
Audit Fees	6,149	20,852	17,972	21,686
Bad Debts Expense	(45)	(45)	(90)	(90)
Communications	21,444	21,567	42,688	50,303
Contractual Services	34,081	28,186	70,094	69,894
Depreciation and Amortization	258,633	213,274	523,671	426,546
Interest Expense	21,937	35,055	47,523	73,736
Management Service Fee	17,722	23,686	35,444	47,372
Multi-State Dues	0	(40,847)	89,435	76,426
Public Relations	3,712	26,107	20,290	53,148
Other	7,965	10,932	16,418	19,858
Personal Services	343,101	319,764	688,260	616,125
Repairs and Maintenance	11,745	6,902	18,269	12,561
Supplies and Materials	15,818	38,102	60,531	136,908
Travel	7,340	8,886	15,853	14,706
Utilities and Rent	27,590	24,958	53,224	48,119
Total Operating Expense	996,970	914,684	2,014,913	1,997,346
Operating Income	2,260,158	1,482,414	3,694,683	4,044,032
NONOPERATING REVENUES (EXPENSES)				
Interest earnings	17,694	38,071	41,363	93,561
Gain/Loss on sale of asset	0		(460)	0
Total Nonoperating Revenues(Expenses)	17,694	38,071	40,903	93,561
Income Before Operating Transfers	2,277,852	1,520,485	3,735,586	4,137,593
Operating Transfers In (Out) - General Fund	(2,277,852)	(1,520,485)	(3,735,586)	(4,137,593)
CHANGE IN NET ASSETS	0	0	0	0
Total Net Assets, Beginning of Period	0	0	0	0
TOTAL NET ASSETS, END OF PERIOD	0	0	0	0

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN NET FUND ASSETS
AND RECONCILIATION OF BUDGET AND ACTUAL (BUDGETARY BASIS) TO GAAP BASIS
FOR THE SIX MONTHS ENDED DECEMBER 31, 2002
(Unaudited)

	<u>Budget</u> Fiscal Year July 1, 2002 - June 30, 2003	<u>Actual</u> Six Months Ended December 31, 2002 (Unaudited)	Actual as a Percent of Final Budget (%)
REVENUES:			
Instant ticket revenue	\$ 10,200,000	\$ 5,019,256	49.21
Powerball revenue	15,200,000	8,989,351	59.14
Montana Cash revenue	4,100,000	1,806,008	44.05
Wild Card revenue	2,600,000	1,282,696	49.33
Hot Lotto revenue	2,900,000	1,148,707	39.61
900 # Income	25,000	9,557	38.23
License, permits, and miscellaneous	2,000	1,824	91.20
Total Revenues	<u>35,027,000</u>	<u>18,257,399</u>	52.12
COST OF TICKET REVENUE			
Prizes - instant ticket	5,916,000	2,998,522	50.68
Prizes - on-line games	12,295,000	6,583,313	53.54
Retailer commissions	2,056,000	1,071,727	52.13
Ticket cost - instant games	728,000	353,819	48.60
Ticket cost - vendor fees	2,922,500	1,540,422	52.71
Total Cost of Ticket Revenue	<u>23,917,500</u>	<u>12,547,803</u>	52.46
OPERATING EXPENSES:			
Advertising	637,576	262,626	41.19
Advertising Production	147,200	52,705	35.81
Audit Fees	60,000	17,972	29.95
Communications	100,015	42,688	42.68
Contractual Services	250,011	70,094	28.04
Interest Expense	81,041	47,523	58.64
Management Service Fee	75,000	35,444	47.26
Multi-State Dues	114,881	89,435	77.85
Public Relations	75,950	20,290	26.71
Other	46,569	16,418	35.26
Personal Services	1,353,906	695,886	51.40
Repairs and Maintenance	27,052	18,269	67.53
Supplies and Materials	200,775	60,531	30.15
Travel	40,490	15,853	39.15
Utilities and Rent	108,288	53,224	49.15
Equipment	21,627	0	0.00
Total Operating Expenses	<u>3,340,381</u>	<u>1,498,958</u>	44.87
Operating Income	7,769,119	4,210,638	54.20
NONOPERATING REVENUES (EXPENSES):			
Interest Earnings	0	5,702	
Security Lending Transactions		0	
Loss on Sale on Asset		(460)	
NET INCOME (BUDGETARY BASIS)	<u>\$ 7,769,119</u>	<u>\$ 4,215,880</u>	54.26
RECONCILIATION OF BUDGETARY/GAAP BASIS:			
1. Capitalized equipment purchases	21,627	0	0.00
2. Adjustment for compensated absences		7,626	
3. Adjustment for depreciation expense	(1,070,747)	(523,671)	48.91
4. Bad Debts		90	
5. MUSL interest earnings	120,000	35,661	29.72
Total Reconciling Items	(929,120)	(480,294)	
NET INCOME (GAAP BASIS)	<u>\$ 6,839,999</u>	<u>\$ 3,735,586</u>	54.61

The accompanying notes are an integral part of these financial statements.

MONTANA LOTTERY
ANALYSIS OF REVENUES AND EXPENSES BY PRODUCT
FOR THE SIX MONTHS ENDED DECEMBER 31, 2002
(UNAUDITED)

	INSTANT	POWERBALL	MONTANA CASH	WILD CARD	HOT LOTTO	ADMIN
REVENUES:	\$ 5,019,256	\$ 8,989,351	\$ 1,806,008	\$ 1,282,696	\$ 1,148,707	\$ 11,381
COST OF TICKET REVENUE:						
Prize Expense	2,998,522	4,358,793	960,951	671,774	591,795	0
Retailer Commissions	410,039	449,748	90,326	64,157	57,457	0
Cost of Tickets Sold	353,819	0	0	0	0	0
Vendor Fees	431,318	753,784	151,439	107,558	96,323	0
NET OPERATING REVENUE	825,558	3,427,026	603,292	439,207	403,132	11,381
OPERATING EXPENSES:						
Advertising	61,152	131,987	23,784	23,059	22,691	(47)
Advertising Production	12,102	11,349	9,751	9,752	9,751	0
Audit Fees	0	0	0	0	0	17,972
Bad Debts	0	0	0	0	0	(90)
Communications	20,671	130	130	130	130	21,497
Contractual Services	18,035	2,445	2,445	2,444	2,445	42,280
Depreciation and Amortization	147,554	254,114	51,344	36,367	32,600	1,692
Interest	13,306	23,255	4,672	3,318	2,972	0
Management Service Fee	13,548	4,204	2,907	2,150	2,022	10,613
Multi-State Dues	0	12,419	0	39,369	13,348	24,299
Public Relations	8,044	2,454	2,454	2,454	2,454	2,430
Other	195	63	63	63	63	15,971
Personal Services	243,614	85,450	60,538	41,355	40,053	217,250
Repairs and Maintenance	0	0	0	0	0	18,269
Supplies and Materials	28,671	3,772	3,689	3,609	3,608	17,182
Travel	3,148	787	787	787	787	9,557
Utilities and Rent	0	0	0	0	0	53,224
TOTAL OPERATING EXPENSES	570,040	532,429	162,564	164,857	132,824	452,099
OPERATING INCOME	255,518	2,894,597	440,728	274,350	270,208	(440,718)
NONOPERATING REVENUES (EXPENSES)						
Security Lending Transactions	0	0	0	0	0	0
Interest Earnings	0	0	0	0	0	41,363
Gain(Loss) on Sale of Asset						(460)
TOTAL NONOPERATING REVEN (EXPENSES)	0	0	0	0	0	40,903
NET INCOME BY PRODUCT	\$ 255,518	\$ 2,894,597	\$ 440,728	\$ 274,350	\$ 270,208	\$ (399,815)
PROFIT AS A % OF REVENUE	5.09%	32.20%	24.40%	21.39%	23.52%	N/A

NOTE: THIS IS ONLY SIX MONTH'S ACTIVITY AND THEREFORE SHOULD NOT BE INTERPRETED TO SHOW HOW OUR PRODUCTS HAVE PERFORMED IN PAST YEARS OR WILL PERFORM IN THE FUTURE.

MONTANA LOTTERY
Notes to the Financial Statements (Unaudited)
December 31, 2002

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity.

The Montana Lottery, established under the provisions of Section 23-7-101, Montana Code Annotated (MCA), was approved by the Montana electorate through Legislative Referendum No. 100 on November 4, 1986.

Montana's first lottery tickets went on sale June 24, 1987.

The Montana Lottery is operated by a five-member commission consisting of Montana residents appointed by the Governor. The Commission, by law, has the power to operate a state lottery, determine the types and forms of lottery games, set the ticket price, number and size of prizes, conduct lottery drawings, enter into agreements to offer lottery games in conjunction with other lottery states and prepare financial reports. The Montana Lottery is attached to the Montana Department of Administration for administrative purposes.

The Montana Lottery is included as an enterprise fund in the State of Montana's Comprehensive Annual Financial Report. In accordance with governmental accounting and financial reporting standards, there are no component units to be included within the Montana Lottery's financial statements as a reporting agency.

Basis of Presentation. The Montana Lottery reports its financial activity in accordance with generally accepted accounting principles (GAAP) as prescribed in pronouncements of the Governmental Accounting Standards Board (GASB).

Enterprise Fund. The Montana Lottery is classified as an Enterprise Fund of the Governmental Proprietary Fund Type. Enterprise Funds account for operations: a) financed and operated similar to private business enterprises, where the intent of the Legislature is that costs are to be financed or recovered primarily through user charges, or b) where the Legislature has decided that periodic determination of revenue earned, expenses incurred, or net income is appropriate.

Basis of Accounting. The Montana Lottery's financial statements are prepared using the accrual basis of accounting. Revenues are recognized in the accounting period in which they are earned and become measurable; expenses are recognized in the period incurred, if measurable.

Revenue Recognition. Lottery instant ticket sales are recorded as revenue based on the time the retailer activates the pack of tickets for sale. In accordance with an established policy, retailers may return unsold tickets to the Lottery for credit. Sales are decreased by an allowance for estimated ticket returns.

Lottery on-line ticket sales are recorded as revenue based on drawings. Tickets sold in advance for future drawings are recorded as deferred revenue until such time as the tickets become valid for the most current drawing.

Free Tickets. Some Montana Lottery instant games award free tickets as prizes. Net lottery ticket revenue does not include the value of free tickets given away and free plays won. The face value of these free ticket prizes distributed for the quarter and six months ended December 31, 2002 was \$68,935 and \$128,680 respectively.

Promotional Credits. The Lottery issues promotional credits to retailers to be used to distribute free tickets to players. The tickets are distributed as part of a promotion run by the retailer, e.g., "Ask for the Sale" or second chance drawings. The Lottery also directly distributes instant tickets for promotional purposes at trade shows, for media give-aways, and during new game introductions. The tickets distributed as a result of promotional credits are reflected as a reduction in revenue. The related prize expense and ticket cost for all promotions are reclassified as an advertising expense. For the quarter ended December 31, 2002, promotional credits resulted in a revenue reduction of approximately \$13,542 and an advertising expense reclassification of approximately \$11,818. For the six months ended December 31, 2002, promotional credits resulted in a revenue reduction of approximately \$42,258 and a prize expense reclassification of approximately \$31,912.

Prizes. Expenses for instant prizes are recorded based on the predetermined prize structure for each game. Expenses for on-line prizes are recorded based on the predetermined prize structure for each on-line game. No prize expense is recorded for free tickets distributed.

Unclaimed Prizes. Prizes for the online games, Powerball, Wild Card, Montana Cash, and Hot Lotto, must be claimed within six months after the appropriate draw date. Prizes for instant games must be claimed within six months of the announced end of each game. The unclaimed prize amounts are taken as a reduction in the Lottery Prizes Payable liability and the Prize Expense and are transferred to the State of Montana General Fund as a portion of the quarterly transfer. The amount of unclaimed prizes for all games is represented in the table below.

	Quarter Ended 12/31/02	Quarter Ended 12/31/01	Year To Date 12/31/02	Year To Date 12/31/01
Online	\$119,201	\$127,981	\$211,381	\$253,901
Instant	<u>74,374</u>	<u>46,954</u>	<u>74,202</u>	<u>172,690</u>
TOTALS	\$193,575	\$174,935	\$285,583	\$426,591

2. SUMMARY OF ACCOUNTS

Cash and Cash Equivalents. Cash and cash equivalents consist of interest-bearing deposits with the Montana Board of Investments short-term investment pool, cash on deposit with a bank and cash on deposit with the Montana State Treasurer that is part of the State's pooled cash and is not separately identifiable as to specific types of securities. These funds are highly liquid and may be drawn on daily.

Cash and cash equivalents consist of the following:

	December 31,	
	<u>2002</u>	<u>2001</u>
Short-term investment pool	\$791,147	\$583,920
Cash on deposit with State Treasurer	165,931	302,447
Cash in revolving deposit account	10,000	10,000
Petty Cash	150	150
TOTALS	\$967,228	\$896,517

Reference to the State of Montana's Comprehensive Annual Financial Report would identify the level of risk associated with cash and cash equivalents in the short-term investment pool and amounts retained with the State Treasurer. The bank balance of the revolving deposit account was \$22,720 at December 31, 2002 and was covered by federal depository insurance. The carrying amount reported in the balance sheet for cash and cash equivalents approximates the fair market value.

Receivables. Receivables include \$2,266,071, representing amounts due the Lottery for tickets purchased by retailers. An allowance for doubtful accounts is reported as net of receivables and is based on historical perspective. As of December 31, 2002 the allowance is zero. An allowance for ticket returns is also included in the receivables amount. This allowance represents a reduction in receivables at December 31, 2002, for estimated ticket returns. This is an estimate

based on returns received to date, as well as, an estimate of tickets unsold by retailers for games that have a public sale end date prior to January 1, 2003. The allowance for ticket returns is \$173,271 at December 31, 2002. The return of vendor fees related to the allowance for returns is \$14,468.

Inventories. Inventories consist of merchandise and supplies inventories. Merchandise inventory includes lottery tickets valued at \$740,416 stored in the warehouse, at retailers prior to being activated by the retailer and with the marketing representatives. These ticket inventories are recorded at cost using the specific identification method and maintained on a perpetual inventory system. Tickets are charged to cost of tickets sold upon activation or after game end.

Supplies inventories include ticket dispensers, premiums and point-of-sale materials. At quarter end, supplies inventories totaled \$80,812. These inventories are also recorded at cost using the specific identification method.

Other Current Assets. Other current assets consist of the following:

	December 31,	
	<u>2002</u>	<u>2001</u>
Prepaid Expenses	15,010	3,851
Employee Advances	<u>4,800</u>	<u>4,800</u>
TOTALS	\$19,810	\$8,651

Transfer Obligations. The account "Transfer Obligations" is \$2,277,852 payable to the General Fund at December 31, 2002.

Compensated Absences. State employees earn vacation leave ranging from 15 to 24 days per year depending on the individual's years of service. Vacation leave may be accumulated not to exceed two times the maximum number of days earned annually. With no limit on accumulation, sick leave is earned at 12 days per year. Upon retirement or termination, an employee is paid 100% for unused vacation and 25% for unused sick leave. The Lottery's liability for compensated absences is detailed below.

<u>Balance</u>	<u>Net Leave</u>	<u>Balance</u>
<u>June 30, 2002</u>	<u>Earned/(Used)</u>	<u>December 31, 2002</u>
\$168,815	\$7,626	\$176,441

Commissions. Section 23-7-301(10), MCA, provides retailers a commission on instant and on-line tickets or chances sold. The Lottery Commission established this commission at 5% of the face value of instant tickets activated by the retailers and the face value of tickets sold for each on-line drawing. For the quarter and the

six months ended December 31, 2002 commissions totaled \$582,355 and \$1,071,727 respectively.

Retailers can receive bonus commissions on tickets sold based on incremental sales of instant tickets. During the quarter and six months ended December 31, 2002 retailers earned bonus commissions of \$74,673 and \$156,580 respectively.

3. MARKETING PRODUCTION EXPENSES

The Lottery has contracted with several vendors to provide marketing related services and materials. These services include media placement, creative design and layout, and media production. Those services and materials not included in the Advertising and Advertising Production expense categories are printing and ticket dispensers. The cost of these services and materials, included in Operating Expenses as Contracted Services and Supplies and Materials, are detailed below for the quarter ended December 31, 2002:

Printing	\$27,242
Ticket Dispensers	<u>7,872</u>
	\$35,114

4. PAYMENTS TO OTHER STATE AGENCIES

The Lottery receives a variety of services and supplies and materials from other state agencies. These services and materials are detailed below for the quarter ended December 31, 2002:

Insurance	\$ 4,709
Warrant Writing Services	254
Payroll Services	456
Audit Fees	3,091
Work Study Contracts	5,433
Computer Fees	12,648
Printing	1,888
State Accounting System Support	7,083
Supplies and Materials	3,941
Mail Processing Fees	3,931
Telecommunications	13,980
Public Relations	7,000
Indirect Costs	39,652
Other	<u>1,051</u>
TOTAL	\$105,117

5. PRIZES

Paid Prizes. Section 23-7-402, MCA states, "A minimum of 45% of the money paid for tickets or chances must be paid as prize money". Prize expense is recorded based on the predetermined prize structure percentage for each game. For the quarter ended December 31, 2002, the prize expense of \$5,248,338 is 51.79% of net Lottery ticket revenue of \$10,133,163. For the six months ended December 31, 2002, the prize expense of \$9,581,835 is 52.51% of net Lottery ticket revenue of \$18,246,018.

6. TRANSFER TO STATE GENERAL FUND

Section 23-7-402(3), MCA, states "That part of all gross revenue not used for payment of prizes, commissions, and operating expenses, together with the interest earned on the gross revenue while the gross revenue is in the enterprise fund, is net revenue. Net revenue must be transferred quarterly from the enterprise fund established by 23-7-401 to the State General Fund." For the quarter ended December 31, 2002, the net revenue payable to the State General Fund totaled \$2,277,852.

7. MULTI-STATE LOTTERY JOINT VENTURE

In November 1989 the Montana State Lottery joined the Multi-State Lottery Association (MUSL). MUSL was created in September 1987 to operate a multi-state lottery game for the benefit of party lotteries. Powerball, Wild Card, and Hot Lotto are the games jointly operated by the members, in which Montana presently participates. Each lottery participating in MUSL is represented on the Board of Directors.

The Multi-State Lottery Receivable with a balance of \$1,733,513, as of December 31, 2002 is comprised of several reserve accounts, which are maintained by the Multi-State Lottery Association (MUSL). The balance of these reserve accounts is as follows:

Powerball Prize Reserve Account	\$791,538
Powerball Unreserved Account	14,466
Powerball Set Prize Reserve Account	506,420
Wild Card Reserve Account	418,556
Hot Lotto Set Prize Reserve Account	<u>2,533</u>
TOTAL	\$1,733,513

The Powerball Prize Reserve Account is to be used only in the event of an unanticipated prize claim. It is an insurance fund intended to protect the member lotteries against the liability that could result from a system failure at one of the member lotteries. All money paid to this fund would be returned to the Lottery one year after the Lottery leaves the Powerball game, assuming that no unanticipated prize claims have been paid. Interest earned on the Lottery's share of the fund, represented by the Unreserved Account, would be returned to the Lottery upon leaving MUSL. The amounts in the Unreserved Account may be used at the Board's discretion.

The Powerball Set Prize Reserve Account is used to fund prize payments for current drawings. Since the Powerball game has fixed prizes, it is often necessary to draw from this reserve to fund payment of prizes at the fixed amount. This account would be returned to the Lottery upon withdrawal from the Powerball Game.

The Lottery contributes to these reserve funds through the 50% set aside for prizes. In addition the Lottery was required to contribute for its portion of the reserve funds accumulated since the start of the Powerball game. The Lottery made this payment in full as of June 1990, through an additional 2% of drawing revenue rather than making a lump sum payment. Payments made to this fund are considered a portion of prize expense associated with the game.

The Wild Card Reserve Account is to be used in the event of an unanticipated prize claim on the Wild Card game. This account is also administered by MUSL and would be returned to the Lottery one year after the Wild Card Product Group of Idaho, Montana and South Dakota is disbanded. The Lottery contributes to this account through the 55% set aside for prizes. Payments made to this fund are considered a portion of prize expense related to the Wild Card game.

The Hot Lotto Set Prize Reserve Account is administered by MUSL and is to be used only in the event of unanticipated prize claims. Hot Lotto replaced the Rolldown game on April 7, 2002, and the amount in the Rolldown Set Prize Reserve Account was transferred to the Hot Lotto reserve account. Like other MUSL games the reserve amount would be returned to the Lottery one year after withdrawal from the Hot Lotto game. The Lottery contributes to the reserve through the 50% set aside for prizes. Payments made to the reserve are considered a portion of the prize expense related to the game.

8. GAMES

Currently, the Montana Lottery games are instant ticket games and four on-line games referred to as Powerball, Montana Ca\$h, Wild Card, and Hot Lotto.

Instant ticket games provide players the opportunity to win instantly by scratching a latex covering to reveal a prize.

The Powerball game allows players the chance to win a minimum pari-mutuel jackpot of approximately \$10 million. A player must match all 6 numbers to win the jackpot; players win prizes ranging from \$3 to \$100,000 for matching less than all 6 numbers. Drawings are held twice weekly on Wednesday and Saturday nights. For any drawing, if no ticket matches 6 out of 6 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot. In March 2001, the Lottery added Power Play to the Powerball game. For an additional bet, the Power Play option provides non-jackpot winners the chance to multiply their prize amount by a factor of two through five.

The Montana Ca\$h game allows players the chance to win a minimum pari-mutuel jackpot of \$20,000. Players select 5 numbers from a field of 37 and must match at least 3 out of 5 to win a prize. Matching 3 of 5 wins \$5 and 4 of 5 wins \$200. The drawing is conducted twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Wild Card game allows players the chance to win a pari-mutuel jackpot, with a guaranteed minimum of \$100,000. Players select 5 numbers from a field of 31 plus one of 16 face cards and must match all 5 numbers and the wild card to win the jackpot; players win prizes from \$1 to \$5,000 for matching less than all 5 numbers and/or the wild card. Drawings are held twice weekly on Wednesday and Saturday nights. If no ticket matches all 5 numbers and the wild card, the jackpot rolls over to the next drawing to create a progressive jackpot.

The Lottery introduced Hot Lotto on April 7, 2002, replacing Rolldown. Hot Lotto allows players the chance to win a pari-mutuel jackpot with a guaranteed minimum of \$1 million. Players choose 5 numbers from a field of 39 plus 1 Hot Ball number from a field of 19; the first 5 numbers and the Hot Ball must be matched to win the jackpot. Players can win prizes ranging from \$2 to \$10,000 by matching less than all 5 numbers and/or the Hot Ball. If no ticket wins the jackpot, it rolls over to the next drawing to create a progressive jackpot. Drawings are held twice weekly on Wednesday and Saturday nights.

Rolldown provided a feature different from any other lotto game; for each drawing, if no ticket won the jackpot, all of the jackpot prize money was distributed to the three lower-tier prize levels on a pari-mutuel basis. Rolldown was discontinued on April 7, 2002.

9. COMMITMENTS - GAMING SUPPLIER CONTRACTS

Instant Tickets. On June 27, 2001 the Montana Lottery Commission approved the award of a one-year contract with Oberthur Gaming Technologies Corp. (Oberthur) for the provision of instant tickets; the resulting contract was signed on August 8, 2001. The contract is for one year with the option for six additional one-year renewals. The contract contains specifications regarding ticket design, printing, game ownership, inspection, and prize structure

Oberthur, as the vendor, provided a performance bond covering the contract term and an errors and omissions policy covering an ultimate net loss of \$7,500,000. The Lottery may terminate this contract by providing proper notification to Oberthur.

On-line Services. On August 18, 1998, the Lottery signed a seven-year contract with Autotote Lottery Corporation to provide an on-line gaming system and associated services beginning March 28, 1999. The contract provides for payments to be made for the purchase of an on-line gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation \$5,025,311 for the system on April 26, 1999. Payment under the contract is also based on 8.35% of weekly Lottery sales.

10. CONTINGENT LIABILITIES - PRIZE ANNUITIES

During fiscal year 1989, the Montana Lottery awarded four Big Spin Jackpot prizes totaling \$5,000,000. The Lottery made the initial payments to the winners in the amount of \$253,088 and on September 26, 1988 the Montana Lottery awarded annuities in the amount of \$2,350,180 to Western National Life. Through these annuities, Western National Life makes the remaining payments to the Big Spin Jackpot winners. As of December 31, 2002 the contingent liability for future prize payments funded through the purchase of annuities was \$998,088.

11. LOTTO*AMERICA/POWERBALL/TRI-WEST JACKPOT PRIZES

Jackpot prizes awarded in the Lotto*America/POWERBALL and TRI-WEST LOTTO games are funded through the purchase of U.S. Treasury Zero-Coupon Bonds purchased in the name of the Montana Lottery by MUSL. MUSL will cash the bonds

each year as they mature and will wire the funds to the Lottery for payment to winners on the Anniversary date of the win.

On January 13, 1990 the Montana Lottery awarded its first Lotto*America jackpot prize totaling \$1,740,000. The first annual payment of \$87,000 was made on February 1, 1990. On May 9, 1990 the Lottery awarded a second Lotto*America jackpot prize of \$3,000,000. The first annual payment of \$150,000 was made on May 23, 1990. A third jackpot prize was awarded on February 2, 1991 for \$7,360,000. The first annual payment of \$368,000 was made February 15, 1991. On November 23, 1991 a fourth jackpot prize was awarded totaling \$46,967,738.57. The first annual payment of \$2,355,738.57 was made December 12, 1991. On April 11, 1992 a fifth jackpot prize was won totaling \$2,000,000. The first annual payment of \$100,000 was made on April 27, 1992.

On July 6, 1994 the Montana Lottery awarded its first Tri-West Lotto jackpot prize totaling \$700,565. The first annual payment of \$35,000 was made on July 26, 1994.

On July 22, 1995 the Montana Lottery awarded its first Powerball jackpot prize totaling \$31,401,655.99. The first payment of \$1,571,655.99 was made on August 8, 1995. On April 5, 1997 the Lottery awarded a second Powerball jackpot prize totaling \$11,000,000. The first annual payment of \$550,000 was awarded on April 18, 1997.

As of December 31, 2002 the combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Lotto*America winners was \$24,287,731. The combined total of future prize payments funded through the purchase of U.S. Treasury Zero-Coupon Bonds for Powerball and Tri-West Lotto winners was \$26,925,218.

On March 27, 1999 the Montana Lottery had a Powerball jackpot winner. The prize was \$35.1 million (\$19.35 million cash option). The winner chose the cash option and was paid a lump sum in June 1999.

12. LEASES

Rent. The Montana Lottery leases its office, administrative and warehouse facilities under a noncancelable lease agreement that is effective March 2002 through February 2007. The monthly lease payments through February 2003 are \$7,150 and will increase 1.5% for years two through five.

13. LONG-TERM DEBT

Note Payable. A contract with Autotote Lottery Corporation required the purchase of an online gaming system including terminals and software. The Lottery paid Autotote Lottery Corporation \$5,025,311 for the system by entering into a loan agreement with Norwest Investment Service, now known as Wells Fargo Brokerage Services, LLC. The loan will be repaid in quarterly installments of \$286,394.30 over five years. The first payment was due July 26, 1999. The interest rate on the loan is 5.12%.

Maturities of Long-term Debt

Year Ended June 30,

2003	1,054,786
2004	1,109,836
2005 and beyond	0
Total	\$ 2,164,622

14. CHANGE IN ACCOUNTING PRINCIPLE

Effective for the year beginning July 1, 2001, the Lottery adopted the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. The adoption resulted in a change in the format and content of the basic financial statements as follows: contributed capital is included as net assets and compensated absences is divided into current and long-term portions. The reported net assets that resulted from this change were included in the transfer to the State's General Fund for the quarter ending June 30, 2002.

Alternative accessible formats of this document will be provided upon request.

